

SALES AND USE TAX PUBLIC PARTICIPATION WORKING GROUP

**Teleconference Minutes**

of

**Phase II Task Force Three**

held **February 3, 1998**, 11:00 am to 12:30pm

**I. Welcome and Introductions.**

Identified teleconference participants:

Karen Boucher

Facilitator

Laticia Johnson (MN)

Roxanne Bland

Mike Madsen

Merle Buff

Wood Miller (MO)

Kaye Caldwell

Paull Mines (MTC)

Alan Friedman

Larry O'Nan (KY)

Jeff Friedman

Art Rosen

Sue Hatfield

Mark Wainwright (UT)

**II. Public Comment Period.**

Paull Mines reminded the group that participants had been asked to provide specific written proposals for the items sought to be included in the Phase II document. The MTC had received no proposals related to the subjects to addressed by this Task Force. He indicated that more productive discussions may be held where specific proposals have been developed.

There was no other public comment.

**III. Phase II Task Force Three evaluation/consideration of proposed topics.**

- a. Statement that economic presence nexus theory will not be pursued by the state. A subset of this policy is that the presence of intangibles situated in the state will not create nexus. Alternative statement that economic presence nexus theory if established in the state by statute, regulation, or judicial law will be applied on a prospective basis only.

The Task Force Three discussion followed the Task Force Two discussion of a couple of days earlier, which, probably owing to that Task Force's assigned topics, was not a rousing success. Therefore, the first inquiry at this discussion was whether the States believed there was any potential interest in this initiative. A Phase 2 document will only become a reality if it has the support of the States.

There was a general indication that this topic did attract interest from the States, although the first two parts of the stated issue under examination probably would not attract a significant level of support. States for the most

part acknowledge that where there has been a change in law, they are prescribed for any number of reasons that do not always relate to precise legal requirements to implement the law change prospectively. Whether recognition of some concept of economic presence would be a law change would require analysis of the exact doctrine being advanced. There is a difference from a change in law and a change in audit position.

Participant Boucher indicated she was willing to draft a generalized statement of what the business community would like to see about prospective application following the recognition of a doctrine of economic presence.

Business representatives also indicated that it would be useful to secure from the States a statement of what their current thinking was about the economic presence doctrine. Dispute ensued as to whether concepts of representation nexus was a subset of economic presence nexus or a form of physical presence. The disagreement disclosed the need to develop a common understanding as to what constitutes economic presence. If States are prepared to state their views about economic presence, then they need to know what it is they are precisely stating. The suggestion that business supply a set of examples of what they consider economic presence for purposes of securing the States' response thereto was advanced.

- b. Addressing the ramifications that goods once sold in tangible form may in the future be sold in intangible form. In this regard, establishment of a policy that the sale, rental or licensing of digital products to end-users will not create nexus.

The foregoing discussion led into a general discussion of how a licensed product like software could ever give rise to establishing nexus under the concept of physical presence. Participants noted that where an intangible is licensed for further commercial exploitation, *e.g.*, the use of the licensed product gives rise to a business situs or an OEM is authorized to use the product for further commercial exploitation, an argument may be available to say that the out-of-state business has sufficient connection with the intangible to be subject to nexus. (This was the approach taken in the provisions pertaining to nexus arising from intangibles that was a part of an earlier version of the Nexus Guideline. The provisions on intangibles was deleted in the face of continuing controversy over how an intangible can ever cause the out-of-state licensor to be physically present. The provisions on intangibles were deleted, because the intensity of the controversy was preventing other provisions of the Guideline from being reviewed seriously. The business representatives requested a copy of the provisions on intangibles that were deleted from the more current versions of the Guideline.)

A participant noted that even end-user software might arguably provide sufficient connection with the taxing State to be a basis for nexus. The example of this circumstance is the licensing of proprietary software that allows the end-user to connect to the out-of-state business for purposes of receiving its electronic product or services. It is the software in *Quill* but only at a level that involves more than a few floppy disks.

Another participant wanted to know what impact would a State's definition of software as "tangible personal property" have on the nexus results. The response from a few is that a Court might accept the classification but that the classification would not answer the question whether the connection to the taxing State was sufficient to support nexus.

The teleconference concluded with Boucher indicating she would develop a general statement about prospective application of new nexus law that presupposes adequate notice in accordance with the States' normal rules to affected taxpayers. Boucher will also attempt to develop a few examples of what types of circumstances would invoke the general principle. After the development of these examples, business will seek to involve as many others as are willing to become involved in illustrating the general principle's application.